

## **REPORT OF THE AUDITOR-GENERAL TO THE KWAZULU-NATAL PROVINCIAL LEGISLATURE AND THE COUNCIL ON EDUMBE MUNICIPALITY**

### **REPORT ON THE FINANCIAL STATEMENTS**

#### **Introduction**

1. I was engaged to audit the financial statements of the eDumbe Municipality set out on pages ... to ..., which comprise the statement of financial position as at 30 June 2012, the statements of financial performance, statement of changes in net assets and cash flows for the year then ended, and the notes, comprising a summary of significant accounting policies and other explanatory information.

#### **Accounting officer's responsibility for the financial statements**

2. The accounting officer is responsible for the preparation and fair presentation of the financial statements in accordance with the South African Standards of Generally Recognised Accounting Practice (SA Standards of GRAP) and the requirements of the Local Government: Municipal Finance Management Act of South Africa, 2003 (Act No. 56 of 2003) (MFMA) and the Division of Revenue Act of South Africa, 2011 (Act No. 6 of 2011) (DoRA), and for such internal control as the accounting officer determines is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error.

#### **Auditor-General's responsibility**

3. My responsibility is to express an opinion on the financial statements based on conducting the audit in accordance with the Public Audit Act of South Africa, 2004 (Act No. 25 of 2004) (PAA), the *General Notice* issued in terms thereof and International Standards on Auditing. Because of the matters described in the Basis for disclaimer of opinion paragraphs, however, I was unable to obtain sufficient appropriate audit evidence to provide a basis for an audit opinion.

#### **Basis for disclaimer of opinion**

#### **Restatement of corresponding figures**

4. As disclosed in note 49 to the financial statement the corresponding figure for the prior year was restated. The municipality was unable to provide sufficient appropriate evidence to support the adjustments of the amount of R3,208 million debited in the prior year's general expense account and adjustments of R2,710 million to the opening balance of accumulated surplus for the 2009-10 financial year. There were no satisfactory alternative procedures that I could perform to obtain reasonable assurance and, consequently, I was unable to determine whether the correction of the error was valid, accurate and appropriately disclosed.

### **Accumulated surplus**

5. The municipality could not provide sufficient appropriate audit evidence to support the amounts for fines totalling R364 560 in the 2009-10 financial year and R47 100 in the current year. There were no satisfactory alternative procedures that I could perform to obtain reasonable assurance as I was unable to obtain sufficient appropriate audit evidence to satisfy myself as to the occurrence, completeness and accuracy of the fines as included in the opening balance for the accumulated surplus.

### **Property, plant and equipment**

6. I was unable to obtain adequate audit evidence to support amounts totalling R405 million, as disclosed in note 2 to the financial statement, for property, plant and equipment. There were no satisfactory alternative procedures that I could perform to obtain reasonable assurance. Consequently, I was unable to obtain sufficient appropriate audit evidence to satisfy myself as to the existence, valuation and completeness, presentation and disclosure and rights relating to property, plant and equipment disclosed.

### **Investment property**

7. As disclosed in note 4 to the annual financial statement, the municipality has investment property amounting to R27,333 million (2011: R18,048 million). However, the municipality incorrectly accounted for the investment property as property plant and equipment in the prior years, and the correction of the prior year error was not accounted for and disclosed correctly as required by SA Standards of GRAP, GRAP 3 - *Accounting policies, changes in accounting estimates and errors*.
8. The municipality used a cost model to account for investment property, as per the accounting policy in the prior year, and accounted using the fair value model in the current year; however, the valuation of investment property was not appropriately supported. Furthermore, the change in accounting policy was not accounted for and disclosed correctly as required by SA Standards of GRAP, GRAP 3 *Accounting policies, changes in accounting estimates and errors*. Therefore, as these misstatements were not corrected in the financial statements, I was unable to satisfy myself as to the valuation and disclosure of investment property.

### **Trade and other receivables**

9. The municipality could not provide sufficient appropriate audit evidence to support journal adjustments of R52 067 million processed for trade and other receivables. There were no satisfactory alternative audit procedures that I could perform to obtain sufficient appropriate audit evidence to satisfy myself as to the rights, existence, valuation and completeness of the trade and other receivables amounting to R13 722 million disclosed in note 6 to the financial statements.

### **Interest received on debtors**

10. The municipality failed to raise interest on overdue accounts. This is contrary to the requirement of section 64(2)(g) of the MFMA, and has resulted in a current year misstatement estimated at R2,262 million, using the prime rate of 8.5% on interest received. Therefore, as the misstatements were not corrected in the financial statements, I was unable to satisfy myself as to the completeness and accuracy of interest received and completeness and valuation of receivables.

### **Revenue**

11. The municipality could not provide sufficient appropriate audit evidence to support journal adjustments of R29,776 million processed for electricity sales and refuse services and a further R455 471 in respect of rental stands. There were no satisfactory alternative audit procedures that I could perform to obtain sufficient appropriate audit evidence to satisfy myself as to the occurrence, completeness and accuracy of revenue amounting to R95,942 million disclosed in note 17, and the existence, valuation, completeness and rights relating to amounts disclosed in note 6 to the financial statements.
12. Discrepancies between the grant revenue as disclosed in note 18 to the financial statements and the grant register presented for audit were noted. An adjustment was made, presenting a difference of R725 620, which was not supported by appropriate audit evidence. There were no satisfactory alternative audit procedures that I could perform to obtain sufficient appropriate audit evidence to satisfy myself as to the occurrence, completeness and accuracy of revenue amounting to R95,942 million disclosed in note 17, and the existence, valuation, completeness and rights relating to amounts disclosed in note 6 to the financial statements.

### **Payables from exchange transactions**

13. I was unable to satisfy myself as to the completeness of trade and other payables amounting to R10,406 million as disclosed in note 12 to the statement of financial position and the related expenses, as the municipality had only addressed and disclosed the unrecorded creditors noted through the audit process. No evidence was provided that the entire population had been evaluated and that misstatements identified had been adjusted accordingly.
14. The municipality could not provide sufficient appropriate audit evidence to support a journal processed to transfer an amount of R1,005 million from a suspense account to trade and other payables. There were no satisfactory alternative audit procedures that I could perform to obtain sufficient appropriate audit evidence to satisfy myself as to the existence, completeness and valuation and obligations pertaining to the amount disclosed in note 12 to the financial statements.

## **Operating lease**

15. The municipality has not complied with the requirements for disclosure as per paragraph 42 of the SA Standards of GRAP, GRAP 13 – *Leases*. The amount disclosed in the statement of financial performance does not agree to the operating lease register and supporting documents provided, resulting in a misstatement of R2,199 million. I could not satisfy myself with the accuracy, completeness and disclosure of operating lease expense.

## **Value-added tax (VAT) payable**

16. As disclosed in note 6 and 13 to the annual financial statements, the municipality has VAT receivable amounting to R3,191 million (2011:R699 942). However, and the municipality did not maintain complete records, schedules and documentation to support the VAT amount. Therefore, there was no alternative audit procedure I could perform to obtain reasonable assurance on the completeness , valuation and existence pertaining to the VAT amount.

## **Leave provision**

17. As disclosed in note 11 to the annual financial statements, the municipality has disclosed a provision for leave amounting to R553 473 (2011: R1,597 million). However, as the municipality could not provide sufficient appropriate audit evidence to support this provision and there was no alternative procedure I could perform to obtain reasonable assurance, I was unable to satisfy myself as to the completeness and valuation of and obligations pertaining to the provision for leave.

## **Commitments**

18. As disclosed in note 42 to the financial statement, the municipality has disclosed commitments amounting to R23,211 million. However, as the municipality did not have adequate controls in place and did not maintain complete records and schedules, misstatements were identified during the audit. These misstatements were not adequately adjusted and no evidence was provided that the entire population had been evaluated and that the municipality had therefore identified and adjusted the total misstatements accordingly. Therefore I could not obtain sufficient appropriate audit evidence to satisfy myself as to the completeness, existence, obligation and valuation of commitments disclosed in the financial statements.

## **Irregular expenditure**

19. I could not satisfy myself as to the completeness of irregular expenditure amounting to R8,156 million disclosed in note 34 to the financial statements, as the misstatements identified during the audit were not adequately adjusted and no evidence was provided that the entire population had been evaluated.

Furthermore, there was insufficient evidence that irregular expenditure of R30,602 million was investigated before being written off as irrecoverable by the council, which is contrary to the requirements of section 32(2)(b) of the MFMA.

### **Unauthorised expenditure**

20. As a result of the significant audit findings on expenditure, as well as capital expenditure being included in the other own expenditure in the comparative figures (budget versus actual) in note 47 to the annual financial statements, I am unable to conclude on the accuracy, valuation and completeness of unauthorised expenditure amounting to R17,972 million as disclosed in note 32 to the annual financial statements.

### **Cash flow statement**

21. I was unable to obtain adequate audit evidence that the cash flow statement and related notes for the current and prior financial years were fairly stated, due to material uncorrected misstatement identified amounting to R31,283 million and due to the material effect of scope limitations and identified misstatements mentioned in this report.

### **Discrepancies between general ledger, trial balance and financial statements**

22. System/mapping errors resulted in material differences between the general ledger, the trial balance and the financial statements of the municipality, thereby limiting reliance on the accounting records provided. Consequently, I was unable to confirm whether the financial statements are fairly presented due to the effect of the errors.

### **Finance leases**

23. The municipality did not comply with the SA Standards of GRAP, GRAP 13, *Leases* that requires a lease to be classified as a finance lease only if it transfers substantially all the risks and rewards incidental to ownership. The municipality is party to the lease agreement amounting to R5 671 million that constitutes an operating leases, however this has been accounted for as finance leases in the accounting records. Furthermore this has not been disclosed in the note to the financial statements, consequently I was unable to satisfy myself as to the accuracy, presentation and disclosure of operating lease expense.

### **Disclaimer of opinion**

24. Because of the significance of the matters described in the basis for disclaimer of opinion paragraphs, I have not been able to obtain sufficient appropriate audit evidence to provide a basis for an audit opinion. Accordingly, I do not express an opinion on the financial statements.

### **Emphasis of matters**

I draw attention to the matters below. My opinion is not modified in respect of these matters.

### **Restatement of corresponding figures**

25. As disclosed in note 48 to the financial statements, the corresponding figures for 30 June 2011 have been restated as a result of an errors discovered during 2012 in the financial statements of the eDumbe Municipality at, and for the year ended, 30 June 2011.

### **Going concern**

26. As disclosed in note 44 to the financial statements of the eDumbe Municipality, there are conditions that indicate the existence of a material uncertainty that may cast significant doubt on the municipality's ability to operate as a going concern.
  
27. As disclosed in note 44 of the annual financial statements, conditional grants are not cashed back. Thus the funds for which conditions have not yet been met on the Municipal Infrastructure Grant and Integrated National Electrification Programme Grant were utilised for purposes other than those stipulated in their respective schedules or gazetted DoRA framework, in contravention of the requirements of section 15(1) of DoRA.

### **Material losses**

28. As disclosed in note 41 to the financial statements, material distribution losses amounting to R1,711 million were incurred as a result of electricity distribution losses.

### **Additional matters**

29. I draw attention to the matters below. My opinion is not modified in respect of these matters.

### **Unaudited supplementary schedules**

30. The supplementary information set out on pages XX to XX do not form part of the financial statements and is presented as additional information. I have not audited these schedules and accordingly I do not express an opinion thereon.

## **REPORT ON OTHER LEGAL AND REGULATORY REQUIREMENTS**

31. In accordance with the PAA and the *General Notice* issued in terms thereof, I report the following findings relevant to performance against predetermined objectives, compliance with laws and regulations and internal control, but not for the purpose of expressing an opinion.

### **Predetermined objectives**

32. I performed procedures to obtain evidence about the usefulness and reliability of the information in the annual performance report as set out on pages ... to ... of the annual report.
  
33. The reported performance against predetermined objectives was evaluated against the overall criteria of usefulness and reliability. The usefulness of information in the annual performance report relates to whether it is presented in accordance with the National Treasury annual reporting principles and whether the reported performance is consistent with the planned objectives. The usefulness of information further relates to whether indicators and targets are measurable (i.e. well defined, verifiable, specific, measurable and time bound) and relevant as required by the National Treasury *Framework for managing programme performance information*.

The reliability of the information in respect of the selected objectives is assessed to determine whether it adequately reflects the facts (i.e. whether it is valid, accurate and complete).

34. The material findings are as follows:

## **Usefulness of annual performance report**

### **Presentation**

35. Improvement measures in the annual performance report for a total of 100% of the planned targets not achieved were not disclosed as required by section 46 of the Municipal Systems Act, 2000 (Act No. 32 of 2000) (MSA). This was due to inadequate internal policies and procedures to address reporting processes and events pertaining to performance management and reporting and limited review of the presentation of the annual performance report by management.

### **Consistency**

36. Section 41(c) of the MSA requires that the actual achievements against all planned indicators and targets must be reported annually. The annual performance report submitted for audit purposes did not include the actual performance of 97% of all planned objectives specified in the integrated development plan for the year under review. This was due to lack of review and monitoring of the performance objectives set to ensure that there was a link between the planned objectives and reported outcomes.

### **Measurability**

37. The National Treasury *Framework for managing programme performance information* (FMPPI) requires that performance targets be specific in clearly identifying the nature and required level of performance. A total of 27% of the targets relevant to basic service delivery and infrastructure development and community and social services development were not specific in clearly identifying the nature and required level of performance. This was due to the fact that management was aware of the requirements of the FMPPI but did not receive the necessary training to enable application of the principles.
38. The National Treasury FMPPI requires that performance targets be measurable. The required performance could not be measured for a total of 25% of the targets relevant to basic service delivery and infrastructure development and community and social services development. This was due to the fact that management was aware of the requirements of the FMPPI but did not receive the necessary training to enable application of the principles.
39. The National Treasury FMPPI requires that indicators should have clear unambiguous data definitions so that data is collected consistently and is easy to understand and use. A total of 34% of the measures relevant to basic service delivery and infrastructure development and community and social services development were not well defined in that clear, unambiguous data definitions were not available to allow for data to be collected consistently. This was due to the fact that management was aware of the requirements of the FMPPI but did not receive the necessary training to enable application of the principles.
40. The National Treasury FMPPI requires that it must be possible to validate the processes and systems that produce the indicator. A total of 87% of the indicators relevant to basic service delivery and infrastructure development and community and social services development were not verifiable in that valid processes and systems that produce the information on actual performance did not exist. This was due to the lack of key controls in the relevant systems of collection/collation/verification/storage of actual performance information.

## **Reliability**

41. The National Treasury FMPPi requires that processes and systems which produce the indicator should be verifiable. A total of 82% of the actual reported performance relevant local economic development, basic service delivery and infrastructure development and community and social services development objectives, respectively, was not valid when compared to the supporting documents provided. This was due to a lack of standard operating procedures for the recording, monitoring and reporting of actual achievements and accountability in this regard by senior management.
42. The National Treasury FMPPi requires that the indicator be accurate enough for its intended use and respond to changes in the level of performance. A total of 100% of the actual reported indicators relevant to local economic development, basic service delivery and infrastructure development and community and social services development were not accurate when compared to source information. This was due to a lack of monitoring/review/standard operating procedures for the recording of actual achievements by senior management.
43. The National Treasury FMPPi requires that documentation addressing the systems and processes for identifying, collecting, collating, verifying and storing information be properly maintained. Source information for 97% of the actual reported performance for the local economic development, basic service delivery and infrastructure development and community and social services development objectives were not completely recorded. This was due to a lack of documentation and a document management system with regard to collation of information to support the actual performance achievements. A further contributing factor was that this information was not recorded, reported and reviewed by management and the governance structures on a quarterly basis.

## **Additional matters**

44. I draw attention to the matters below. My conclusion is not modified in respect of these matters:

### **Achievement of planned targets**

45. Of the total number of targets planned for the year, only 6 targets were achieved during the year under review. This represents 95% of total planned targets that were not achieved during the year under review.
46. This was mainly due to the fact that indicators and targets were not suitably developed during the strategic planning process

## **Compliance with laws and regulations**

47. I performed procedures to obtain evidence that the municipality had complied with applicable laws and regulations regarding financial matters, financial management and other related matters. My findings on material non-compliance with specific matters in key applicable laws and regulations, as set out in the *General Notice* issued in terms of the PAA, are as follows:

## **Annual financial statements and performance report**

48. The financial statements submitted for auditing were not prepared in all material respects in accordance with the requirements of section 122 of the MFMA. Material misstatements identified by the auditors were not adequately corrected, which resulted in the financial statements receiving a disclaimer of opinion.

49. The annual performance report for the year under review does not include a comparison of the performance with set targets/ a comparison with the previous financial year and measures taken to improve performance, as required by sections 46(1)(b) and (c) of the MSA.

## **Budgets**

50. Expenditure was incurred that was in excess of the limits provided for in the votes of the approved budget, in contravention of section 15 of the MFMA.

## **Internal audit**

51. The internal audit unit did not audit the performance measurements on a continuous basis and/or submit quarterly reports on their audits to the municipal manager and the performance audit committee, as required by municipal planning and performance management regulation 14(1)(c).

## **Procurement and contract management**

52. Goods and services with a transaction value of between R10 000 and R200 000 were procured without obtaining written price quotations from at least three different prospective providers as per the requirements of municipal supply chain management regulation (MSCMR) paragraph 17(a) and (c).

53. Goods and services of a transaction value above R200 000 were procured without inviting competitive bids as per the requirements of MSCMR regulations 19(a) and 36(1).

54. Awards were made to persons whose tax matters have not been declared by South African Revenue Services to be in order, in contravention of the requirement of MSCMR paragraph 43.

## **Expenditure management**

55. The accounting officer did not take effective steps to prevent unauthorised expenditure, irregular expenditure and fruitless and wasteful expenditure, as required by section 62(1)(d) of the MFMA.

## **Conditional grants**

56. As per note 45 to the annual financial statements, the grants are not cashed back. Thus the unspent portions of the Municipal Infrastructure Grant and Municipal Systems Infrastructure Improvement Grant were utilised for purposes other than those stipulated in their respective schedules or gazetted DoRA framework, in contravention of the requirements of section 15(1) of DoRA.

## **Revenue management**

57. Interest was not charged on all arrears accounts as required by section 64(2)(g) of the MFMA.

## **Asset management**

58. The accounting officer did not take all reasonable steps to ensure that the municipality had and maintained a management, accounting and information system which accounts for the assets of the municipality as required by section 63(2)(a) of the MFMA.

## **Liabilities**

59. Long-term debt was incurred without a resolution of the municipal council approving the debt agreement, in contravention of section 46(2) of the MFMA.

## **Internal control**

60. I considered internal control relevant to my audit of the financial statements, annual performance report and compliance with laws and regulations. The matters reported below under the fundamentals of internal control are limited to the significant deficiencies that resulted in the basis for disclaimer of opinion, the findings on the annual performance report and the findings on compliance with laws and regulations included in this report.

## **Leadership**

61. The accounting officer did not exercise adequate oversight of financial and performance reporting and compliance as well as internal control. In this regard, the accounting officer did not periodically assess whether staff members had essential skills and knowledge to support the achievement of credible reporting.

## **Financial and performance management**

62. Adequate processes and controls were not in place to implement proper record keeping in a timely manner to ensure that complete, relevant and accurate information is accessible and available to support financial and performance reporting. Furthermore, the accounting officer and chief financial officer did not prepare regular, accurate and complete financial and performance reports that are prepared and supported and evidenced by reliable information. Also there was no adequate review done on the annual financial statement before submission for audit and this resulted in material misstatement and limitation of scope.

## **OTHER REPORTS**

### **Investigations**

63. The municipality had investigations in progress which involves one employee who was charged and suspended for suspected fraud and corruption. Also three other employees charged without suspension for financial misconduct and maladministration.

Pietermaritzburg

30 November 2012



*Auditing to build public confidence*